



GAO

Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

May 4, 2001

**TO AUDIT OFFICIALS AND OTHERS INTERESTED IN
GOVERNMENT AUDITING STANDARDS**

GAO invites your comments on the accompanying proposed changes to *Government Auditing Standards* (GAGAS), commonly known as the “yellow book.” These changes propose revising the second general standard, independence, to expand the definition of personal impairments, highlight the distinction between external and internal reporting, and acknowledge the ways that organizations can be free from organizational impairments to independence. This letter describes the process followed in revising the standards, summarizes comments received on an earlier preliminary views document, discusses the proposed changes from the preliminary views document to this exposure draft, outlines the format of this exposure draft, and requests comments from interested parties on these proposed revisions.

To help ensure that the standards continue to meet the needs of the audit community and the public it serves, the Comptroller General of the United States appointed the Advisory Council on Government Auditing Standards to review the standards and recommend necessary changes. The council includes experts in financial and performance auditing drawn from all levels of government, private enterprise, public accounting, and academia. Public comment is requested on all draft revisions to the standards.

In February 2000, the council recommended to the Comptroller General that a preliminary views draft be issued rather than an exposure draft to reflect the complexity and diverse views associated with the auditor independence issues. The council suggested reaching out to all users of the standards to help formulate possible solutions. The preliminary views document, issued on April 14, 2000, primarily focused on issues associated with organizational independence and identified one possible solution. However, the council acknowledged that there could be additional views and issues to consider and invited respondents to identify and comment to assist the council and GAO in their deliberations.

GAO received 101 comment letters on the preliminary views document from all levels of government and other organizations. Most of the comment letters did not support the preliminary views draft approach to independence issues, but at the same time offered a wealth of information to assist the council and GAO staff in formulating other possible solutions and in considering additional issues. Each comment letter was reviewed and carefully considered.

The comment letters on the preliminary views document raised several major points associated with the proposal. First, most of the federal inspectors general and many of the

state inspectors general commented that the preliminary views document conflicted with their enabling legislation that established independent audit organizations. These respondents expressed their belief that since legislation created them to be independent and provided a range of safeguards to independence, the auditing standards should recognize legislative provisions. Second, internal auditors commented that the preliminary views document disenfranchised this function from recognition under these standards. The internal auditors also noted the lack of compatibility between the preliminary views document and the Institute of Internal Auditors (IIA) standards, concluding that many would elect to use the IIA standards instead. Third, state auditors and others did not agree with the preliminary views document that allowed audit organizations that are not independent to issue opinions on the financial statements when required by statute and with an accompanying disclosure of the circumstances. Fourth, many comments were received that pointed out that the preliminary views document did not consider that a broad range of safeguards may be in place to collectively ensure the independence of the audit organization. Lastly, the comment letters also noted that the issue of independence is broader than organizational independence as described by the preliminary views document. As such, a number of respondents suggested that the Council should recommend that the exposure draft expand its focus to address independence issues associated with auditors providing nonaudit services to the audited entity.

In addressing these and other concerns raised by the individual comment letters, the council recommended to GAO that substantive changes be made to the preliminary views document and focused on three primary areas for possible revision. First, the council agreed with the comments received that noted the ambiguity of the sections on personal impairments and suggested that GAO expand the examples of personal impairments and add criteria to help audit organizations understand whether the provision of the nonaudit service affects the subject matter of the audit. The recent debate regarding the Securities and Exchange Commission's ruling on auditor independence provided valuable information that was used in considering the types of nonaudit services that could impair an audit organization's independence. This exposure draft emphasizes that auditors and audit organizations have an obligation to evaluate circumstances and relationships on each assignment to identify situations that could result in an actual or perceived impairment to independence, including whether the performance of nonaudit services affects the subject matter being audited.

Second, the council suggested that a distinction be made between external and internal reporting. The council's advice is that internal auditors play a vital role in government auditing and can be free from organizational impairments to independence. However, the council emphasized to GAO that fundamental differences exist in auditor responsibilities when audit work is performed to report externally to third parties outside the audited entity and when audit work is performed to report internally to management within the audited entity. Accordingly, this exposure draft incorporates the sections on internal audit in the 1994 revision of *Government Auditing Standards* but refocuses the discussion to organizational impairment considerations when reporting internally to management. The internal audit organization would be required to document the conditions in place that allow it to be considered free of organizational impairments to report internally and have the documentation available for review during the external quality assurance review to ensure that all necessary safeguards have been met. The council also recommended that an internal audit organization could be organizationally independent to report externally if auditing an entity that is external to the one they are assigned, such as a contractor.

Third, the council recommended expanding the criteria that define organizations that can report externally. Based on the comment letters received on the preliminary views document, the council advised GAO that there are a number of ways audit organizations can be free from organizational impairments to report externally. Specifically, this exposure draft proposes expanding the presumptive criteria to include audit organizations for which the heads are appointed by, are accountable to, report to, and can be removed by a statutorily created governing body. The exposure draft also adds to the presumptive criteria to include an audit organization that is assigned to the same branch of government as the audited entity but a different agency within that branch, such as an executive branch auditor auditing a different executive branch agency's program.

In addition, this exposure draft recognizes that there may be other organizational structures under which a government audit organization could be considered to be free from organizational impairments, and thereby considered organizationally independent to report externally. These other structures provide sufficient safeguards to prevent the audited entity from interfering with the audit organization's ability to perform the work and report the results impartially. For the audit organization to be considered free from organizational impairments to report externally, the audit organization needs to have all of the statutory protections listed in the exposure draft. In these situations, the audit organization is required to document the statutory provisions in place and have the documentation available for review during the external quality assurance review to ensure that a third party agrees that the necessary safeguards have been met.

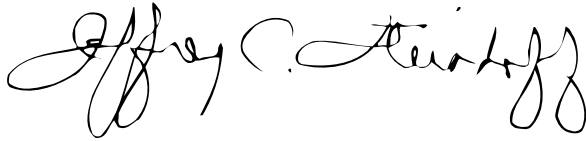
This draft is being sent to financial management and audit officials at all levels of government, the public accounting profession, academia, professional organizations, and public interest groups. We encourage you to send your comments, whether you wish to comment on the entire document or only a portion of it. All comments will be distributed to the entire council and will be considered during further deliberations.

In the exposure draft, italicizing and bolding are used to identify potential added language and striking-out is used to identify potential deleted language from the 1994 revision of *Government Auditing Standards*. To facilitate review of the exposure draft, it is located on the Internet on GAO's Home Page (www.gao.gov). Additional copies of this exposure draft can be obtained from the U.S. General Accounting Office, Room 1100, 700 4th Street, NW, Washington, DC 20548, or by calling (202) 512-6000.

To facilitate analysis of your comments, it would be helpful if you sent them both in writing and on diskette (in Word or ASCII format). To ensure that your comments are considered by the council in their deliberations, please submit them by July 30, 2001, to the following address:

Government Auditing Standards Comment
Independence Exposure Draft
U.S. General Accounting Office
Room 5X16 (FMA)
441 G Street, NW
Washington, DC 20548

If you need additional information, please call Marcia B. Buchanan, Assistant Director, Financial Management and Assurance, at (202) 512-9321.

A handwritten signature in black ink, reading "Jeffrey C. Steinhoff". The signature is fluid and cursive, with the first name "Jeffrey" being more prominent and the last name "Steinhoff" following in a similar style.

Jeffrey C. Steinhoff
Managing Director
Financial Management
and Assurance

INDEPENDENCE

3.11 The second general standard is:

In all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, should be free both in fact and appearance from personal, ~~and external, impairments to independence,~~ should be and organizationally independent impairments to independence and should maintain an independent attitude and appearance.

3.12 This standard places responsibility on each auditor and audit organization to maintain independence, so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. ~~3.13—Auditors should consider not only whether they are independent and their attitudes and beliefs permit them to be independent but also whether there is anything about their situations that might lead others to question their independence. All situations deserve consideration because it is essential not only that auditors are in fact, independent and impartial but also that~~

*An auditor should avoid situations that could lead reasonable knowledgeable third parties **with knowledge of the relevant facts and circumstances to conclude that the auditor is not able to maintain independence and, thus, is not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work.*** ~~consider them so.~~

3.13 Government auditors, ~~including hired consultants and internal experts and specialists,~~ need to consider three general classes of impairments to independence—personal, external, and organizational. If one or more of these impairments affects an auditor’s *capability* to ~~do~~ **perform** the work and report results impartially, that auditor should either decline to perform the work, or in those situations ~~where~~ **in which** that auditor cannot decline to perform the ~~audit~~ **work**, the impairment(s) should be reported in the scope section of the audit report.¹ ~~Also, when auditors are employees of the audited entity, that fact should be reflected in a prominent place in the audit report.~~

3.14 Nongovernment auditors ~~also~~ need to consider those personal and external impairments that might affect their ~~abilities~~ *capability* to ~~do their~~ **perform the** work and report their results impartially. If their ~~abilities are affected~~ ***independence is impaired***, they should decline to perform the ~~audit~~ **work**. ***In addition to the guidance on personal and external impairments in GAGAS,*** public accountants² should follow the American Institute of Certified Public Accountants (AICPA) code of professional conduct and the code of professional conduct ***and the regulations*** of the state board with jurisdiction over the practice

¹*In the disclosure, auditors should consider addressing the following issues in the scope section: (1) the cause of the impairment, (2) the mandate to do the audit, and (3) any compensating actions taken to minimize the impairment.*

²*Public accountants are certified public accountants, persons working for licensed certified public accounting firms, or public accountants licensed on or before December 31, 1970, or persons working for public accounting firms licensed on or before December 31, 1970.*

of the public accountant and the audit organization.³ ~~and the guidance on personal and external impairments in these standards.~~

3.15 In using the work of specialists,⁴ auditors need to assess whether any of the three general classes of impairments to independence affect these individuals' capability to perform the work and report results impartially. In conducting this assessment, auditors should obtain representations from the specialists regarding their independence from the activity or program under audit. If the specialist has an impairment to independence, the auditor should use the work of another specialist. If the specialist has an appearance of impairment to independence, the auditor should consider using the work of another specialist who does not have an impairment. If the auditor decide to continue to use the work of specialists whose independence may be impaired, the auditor should perform additional procedures with respect to some or all of the specialists' assumptions and methods to determine whether the results are reasonable,⁵ or engage another specialist for this purpose.

³Public accountants also may be subject to other rules and regulations in addition to GAGAS and those listed above. Such rules may include requirements issued by various levels of government, such as specific requirements for auditors to be engaged to conduct work for the Department of Labor. Auditors should exercise sound professional judgment to ensure they meet any additional rules and regulations.

⁴Specialists to whom this section applies include, but are not limited to, actuaries, appraisers, attorneys, engineers, environmental consultants, medical professionals, statisticians, and geologists. This section also applies to external consultants and firms performing work for the audit organization.

⁵Auditors need to assess their own qualifications to perform this work. If they are not qualified, they should engage another specialist for this purpose.

Personal Impairments

3.16 ~~There are circumstances under which auditors may not be impartial, or may not be perceived as impartial.~~ The audit organization *should* ~~is responsible for having~~ policies and procedures in place *an internal quality assurance system* to help determine if auditors have any personal impairments to independence *that could affect their impartiality or the appearance of impartiality.* ~~Managers and supervisors~~ *The audit organization* needs to be alert for personal impairments *to independence* of ~~their~~ *its* staff members. *Personal impairments of staff members are relationships that might cause an auditor to limit the extent of the inquiry, limit disclosure, or weaken or slant audit findings in any way.* Auditors are responsible for notifying the appropriate officials within their audit organizations if they have any personal impairments *to independence.* ~~These impairments apply to individual auditors, but they may also apply to the audit organizations.~~ *Examples of personal impairments of individual auditors* include, but are not limited to, the following:

- ~~a. official, professional, personal or financial relationships that might cause an auditor to limit the extent of the inquiry, to limit disclosure, or to weaken or slant audit findings in any way;~~
- a. preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit,

- b. ~~previous responsibility for~~ ***managing an entity or*** decision-making ~~or~~
~~managing an entity that c~~would affect ~~current~~ operations of the entity or
program being audited, ***for example as a director, officer, or employee of the***
entity, activity, or program being audited, or as a member of management in
any decision-making, supervisory, or ongoing monitoring function for the
entity, activity, or program under audit,^{6 7 8}
- c. biases, including those induced by political or social convictions, that result
from employment in, or loyalty to, a particular group, organization, or level of
government,
- d. ***concurrent or*** subsequent performance of an audit by the same individual
who, ~~for example,~~ ***maintained the official accounting records when such***
services involved preparing source documents or originating data, in
electronic or other form; authorizing, executing, or consummating
transactions (for example, approving invoices, payrolls, claims, or other
payments of the entity or program being audited), maintaining an entity's

⁶If the auditor has performed other nonaudit services for a client that affect information that is the subject of the audit and management is unable or unwilling to take responsibility for this information, the risk that the auditor may be perceived to have a personal impairment to independence is increased. See paragraphs 3.17 and 3.18 for additional guidance on impairments to independence associated with the scope of services that may be provided by audit organizations to entities they audit.

⁷The auditor needs to be free from this personal impairment for the period covered by the activity under audit, including any financial statements being audited, and for the period in which the audit is being performed and reported.

⁸Serving as a member of the governing board of the entity under audit creates a personal impairment to independence. However, serving on an advisory board for the audited entity, in of itself, does not impair the auditor's independence, unless that advice directly relates to the activity or program under audit.

*bank account or otherwise having custody of the audited entity's funds; or otherwise exercising authority on behalf the entity, or having authority to do so,*⁹ ~~and had previously approved invoices, payrolls, claims, and *or* other proposed payments of the entity or program being audited;~~

- ~~g. concurrent or subsequent performance of an audit by the same individual who maintained the official accounting records;~~¹⁰ ~~and~~
- e. financial interest that is direct, or is substantial though indirect, in the audited entity or program.

3.17 Given the evolving nature of services provided by audit organizations, care needs to be taken to avoid situations that can impair independence. Situations in which an audit organization provides certain nonaudit services to an entity and also performs the audit of that entity could create an impairment for the audit organization. Audit organizations need to consider whether the provision of the nonaudit services affects the subject matter of the audit.¹⁰ ***Specific examples of the types of nonaudit services under the above circumstances that if an audit organization provides them, with certain exceptions as specified below, create personal impairments to independence include the following:***

⁹See footnote 7.

¹⁰For example, an individual performs a substantial part of the accounting process or cycle, such as analyzing, journalizing, posting, preparing, adjusting, and closing entries, and preparing the financial statements, and later the same individual performs an audit. In instances in which the auditor acts as the main processor for transactions initiated by the audited entity, but the audited entity acknowledges responsibility for the financial records and financial statements, the independence of the auditor is not necessarily impaired.

a. Providing bookkeeping or other similar services¹¹ related to the audited entity's accounting records, financial statements, or other records subject to audit. The audit organization cannot maintain or prepare the audited entity's basic accounting records or maintain or take the responsibility for basic financial or other records that the audit organization will audit.¹²

b. Designing or implementing information systems.¹³ The audit organization cannot design the information technology system that supports the program or activity being audited or that generates the other records that will be audited, or provide the primary basis for determining the adequacy of the system.

However, the audit organization can provide information technology services to design or implement systems if management (1) acknowledges responsibility for the entity's system of internal control, (2) identifies a person within management to make all management decisions with respect to the project, (3) makes all significant decisions with respect to the project, (4) evaluates the adequacy and results of the project, and (5) does not rely on the auditor's work as the primary basis for determining the adequacy of its system. In addition,

¹⁰ See footnote 7.

¹¹ Other similar services would include maintaining, preparing, or taking responsibility for the audited entity's other records on an outsourcing basis if these other records affect the subject matter of the audit.

¹² The auditor can assist the audited entity in preparing financial statements based on information in the entity's records. However, care should be taken not to perform management functions or make management decisions for the entity under audit; these responsibilities remain with the entity's management.

¹³ Design or implementation of a information system includes making decisions concerning the systems to be evaluated and selected; the controls and system procedures to be implemented; the scope and timetable of system implementation; or the testing, training, and conversion plans. It also includes evaluating the adequacy and the results of the information system.

the audit organization cannot operate or supervise the operation of the entity's information technology systems.

- c. Providing appraisal or valuation services. The audit organization cannot perform appraisal or valuation services if it is reasonably likely that the results of any valuation or appraisal would be material to the financial statement amounts or other information that will be audited by the audit organization. However, the audit organization can provide appraisal or valuation services if (1) the audit organization is reviewing the work of the audited entity or a specialist employed by the audited entity and the audited entity or specialist provides the primary support for the balances recorded in the financial statements or other information that will be audited, (2) the audit organization's actuaries value the audited entity's pension, other postemployment benefit, or similar liabilities, provided that the audited entity has determined and taken responsibility for all significant assumptions and data, or (3) the valuation is performed in the context of the planning and implementation of a tax-planning strategy or for tax compliance services.*
- d. Providing actuarial services. The audit organization cannot perform actuarial services when they involve the determination of amounts that are material to the financial statements or other information that will be audited by the audit organization unless (1) the audited entity uses its own actuaries or third-party actuaries to provide management with the primary actuarial capabilities, (2)*

management accepts responsibility for any significant actuarial methods and assumptions, and (3) the audit organization's involvement is not continual.

However, the audit organization can provide actuarial services if they (1) assist management in developing appropriate methods, assumptions, and amounts for policy and loss reserves and other actuarial items presented in financial reports based on the audited entity's historical experience, current practice, and future plans, (2) assist management in the conversion of financial statements from a statutory basis to one conforming with generally accepted accounting principles, (3) analyze actuarial considerations and alternatives in federal income tax planning, or (4) assist management in the financial analysis of various matters, such as proposed new policies, new markets, business acquisitions, and reinsurance needs.

- e. Performing management functions. For example, the audit organization would be impaired when an auditor of the organization functions as a member of management in any decision-making, supervisory, or ongoing monitoring function for the audited entity, program, activity, or function, or acts, temporarily or permanently, as a director or officer of the audited entity.*
- f. Performing human resources services. For example, the audit organization cannot search for or seek out prospective candidates for executive, director, or key managerial positions;¹⁴ perform psychological testing, or other formal*

¹⁴A key managerial position has a direct impact on the program or management function subject to audit.

testing or evaluation programs of such prospective candidates; undertake reference checks of prospective candidates; act as a negotiator with the prospective candidate on the audited entity's behalf; or make any related hiring decisions regarding a specific candidate for such a specific job. The audit organization may, upon the request of the audited entity, interview candidates and advise the audited entity on the candidate's competence for financial accounting, administrative, or control positions.

g. Providing broker-dealer services. For example, the audit organization cannot serve as a broker-dealer, promoter, or underwriter of the audited entity's securities.

h. Preparing indirect cost proposals. For example, the audit organization cannot prepare the indirect cost proposal or cost allocation plan when indirect costs recovered by the audited entity are material to its financial statements or the subject matter of the audit.

3.18 Auditors and audit organizations may encounter many different circumstances or combinations of circumstances; therefore, it is impossible to define every situation that could result in an impairment. Auditors and audit organizations have an obligation to evaluate circumstances and relationships on each assignment to identify situations that could result in an actual or perceived impairment to independence, including whether performing nonaudit services

affects the subject matter being audited. The audit organization may need to assess whether multiple situations or circumstances that individually are not personal impairments to independence may become impairments when considered in the aggregate.

3.19 Situations may occur in which the auditor or the audit organization has an inadvertent violation of the independence standard that is discovered during the conduct of the audit, such as those situations that could result in an actual or perceived impairment to independence. An inadvertent violation would not impair the independence of the audit organization or the assignment team provided that the audit organization has an internal quality control system in place that identifies an actual or perceived violation before the report is issued. This internal quality control system should, at a minimum, require the auditor to promptly report any inadvertent violations resulting from any changes in relationships to the audit organization. Once discovered, inadvertent violations need to be mitigated promptly. To mitigate inadvertent violations, (1) the audit organization promptly removes the auditor from the assignment and (2) the audit organization gives additional care to reviewing the work of the auditor. If mitigating actions cannot be taken, the auditor and the audit organization should withdraw from performing the audit, or in situations in which government auditors cannot withdraw, they should follow the guidance in paragraph 3.13.

External Impairments

- 3.20 Factors external to the audit organization may restrict the ~~audit~~ **work** or interfere with an auditor's ability to form independent and objective opinions and conclusions. For example, under the following conditions, an auditor may not have complete freedom to make an independent and objective judgment and an audit may be adversely affected:
- a. external interference or influence that ***could*** improperly or imprudently limits or modifies the scope of an audit ***or threaten to do so,***
 - b. external interference with the selection or application of audit procedures or in the selection of transactions to be examined,
 - c. unreasonable restrictions on the time allowed to complete an audit ***or issue the report,***
 - d. interference external to the audit organization in the assignment, appointment, and promotion of audit personnel,
 - e. restrictions on funds or other resources provided to the audit organization that adversely affect the audit organization's ability to carry out its responsibilities,

- f. authority to overrule or to *inappropriately* influence the auditor's judgment as to the appropriate content of the report, and
- g. influences that jeopardize the auditor's continued employment for reasons other than competency or the need for audit services.

Organizational Impairments

3.21 Government auditors' *capability to perform the work and report the results*

impartially independence can be affected by their place within government and the structure of the government entity which they are assigned to audit.

Whether they are performing work to report externally to third parties outside the audited entity or internally to top management within the audited entity, auditors need to be free from organizational impairments to independence. by their place within the structure of the government entity to which they are assigned and also by whether they are auditing internally or auditing other entities.

Organizational Impairment Considerations

When Reporting Externally to Third Parties

3.23 Government auditors employed by audit organizations whose heads are elected and legislative auditors auditing executive entities may be considered free of

~~organizational impairments when auditing outside the government entity to which they are assigned.~~

3.22 *Government auditors can be presumed to be free from organizational impairments to independence when reporting externally to third parties if their audit organization is organizationally independent from the audited entity. Government audit organizations can meet the requirement for organizational independence in a number of ways.*

3.23 *First, a government audit organization may be presumed to be independent of the audited entity, assuming no personal or external impairments exist, free from organizational impairments to independence from the audited entity to report externally, if the entity is audit organization is*

- a. ***assigned to*** a level of government other than the one to which ***the audited entity is*** ~~they are assigned~~ (federal, state, or local), ***for example, a federal auditor auditing a state government program, or***
- b. ***assigned to*** a different branch of government within the ***same*** level of government ~~to which~~ ***as the audited entity, for example, a legislative auditor auditing an executive branch program*** ~~they are assigned~~ (legislative, executive, or judicial), ***or***

- c. *assigned to the same level of government as the audited entity but a different entity within that level, for example, an executive branch auditor auditing a different executive branch agency's program.*

3.24 *Second, a government audit organization may also be presumed to be independent, assuming no personal or external impairments exist, free from organizational impairments for external reporting if the audit organization's head is meets any of the following criteria:*

- a. *is directly elected by voters of the citizens of their jurisdiction being audited,*
- b. *is elected or appointed by a legislative body of the level of government to which they are assigned, subject to removal by a legislative body, and reports the results of audits to and is are accountable to a legislative body,*
- c. *is appointed by the chief executive someone other than a legislative body, but confirmed by, so long as the appointment is confirmed by a legislative body and removal from the position is subject to oversight or approval by a legislative body,¹⁵ and reports the results of audits to and are-is accountable*

¹⁵*Legislative bodies may exercise their confirmation powers through a variety of means as long as they are involved in the approval of the individual to head the audit office. This involvement can be demonstrated by approving the individual after the appointment or by initially selecting or nominating an individual or individuals for appointment by the appropriate authority.*

to a legislative body of the level of government to which they are assigned.,
or

- d. is appointed by, accountable to, reports to, and can only be removed by a statutorily created governing body, the majority of whose members are independently elected or appointed and come from outside the organization being audited.*

3.25 In addition to the presumptive criteria in paragraphs 3.23 and 3.24, GAGAS recognize that there may be other organizational structures under which a government audit organization could be considered to be free from organizational impairments, and thereby be considered organizationally independent to report externally. These other structures should provide sufficient safeguards to prevent the audited entity from interfering with the audit organization's ability to perform the work and report the results impartially. For the audit organization to be considered free from organizational impairments to report externally under a structure different from the ones listed in paragraphs 3.23 and 3.24, the audit organization should have all of the following safeguards:

- a. statutory protections that prevent the abolishment of the audit organization by the audited entity,*

- b. statutory requirements that if the head of the audit organization is removed from office, the head of the agency should report this fact and the reasons for the removal to the legislative body,*
- c. statutory protections that prevent the audited entity from interfering with the initiation, scope, timing, and completion of any audit,*
- d. statutory protections that prevent the audited entity from interfering with the reporting on any audit, including the findings, conclusions, and recommendations, or the manner, means, or timing of the audit organization's reports,*
- e. statutory requirements that the audit organization report to a legislative body or other independent governing body on a recurring basis,*
- f. statutory protections that give the audit organization sole authority over the selection, retention, and dismissal of its staff, and*
- g. statutory access to records and documents that relate to the agency, program, or function being audited.¹⁶*

¹⁶Statutory authority to issue a subpoena to obtain the needed records is one way to meet the requirement for access to records.

3.26 If the head of the audit organization concludes that the organization meets all the safeguards listed in paragraph 3.25, the audit organization should be considered free from organizational impairments to independence when reporting the results of its audits externally to third parties. The audit organization should document the statutory provisions in place that allow it to meet these safeguards. Those provisions should be reviewed during the external quality assurance review to ensure that all the necessary safeguards have been met.

Organizational Impairment Considerations

When Reporting Internally to Management

3.27 Certain federal, state, or local government audit organizations, or an audit organizations within other government entities, such as a public colleges, universityies, or hospitals, employ auditors to work for management of the audited entities. These auditors may be subject to administrative direction from persons involved in the government management process. Such audit organizations are internal audit organizations. To help achieve organizational independence, audit organizations should report the results of their audits and be accountable to the head or deputy head of the government entity and should be organizationally located outside the staff or line management function of the unit under audit. A government internal audit organization can be presumed to be free from organizational impairments to independence when reporting internally to management if the head of the audit organization meets all of the following criteria:

- a. is accountable to the head or deputy head of the government entity,*
- b. is required to report the results of the audit organization's work to the head or deputy head of the government entity, and*
- c. is located organizationally outside the staff or line management function of the unit under audit.*

3.28 *If the conditions of paragraph 3.27 are met, the audit organization should be considered free of organizational impairments to independence to audit internally and report objectively to the entity's management. Further distribution of reports outside the organization should only be made in accordance with applicable law, rule, regulation, or policy. In these situations, the fact that the auditors are auditing in their employing organizations should be clearly reflected in the auditors' reports.*

3.29 Auditors ~~should also~~ **need to** be sufficiently removed from political pressures to ensure that they can conduct their audits objectively and can report their findings, opinions, and conclusions objectively without fear of political repercussions. Whenever feasible, auditors within internal audit organizations should be under a personnel system in which compensation, training, job tenure, and advancement are based on merit.

3.30 The audit organization's independence is enhanced when it also reports regularly to the entity's independent audit committee and/or the appropriate government oversight body.

~~3.21 If the above conditions are met, and no personal or external impairments exist, the audit staff should be considered organizationally independent to audit internally and free to report objectively to top management.~~

3.31 When organizationally independent internal auditors conduct *internal audit organizations that are free of organizational impairments to independence perform* ~~conduct~~ audits external to the government entity~~ies~~ to which they are directly assigned, *such as auditing contractors or outside party agreements, and no personal or external impairments exist*, they may be considered independent of the audited entity~~ies~~ and free to report objectively to the heads or deputy heads of the government entity~~ies~~ to which they are assigned *and to parties outside the organizations in accordance with applicable law, rule, regulation, or policy.*

3.32 *The audit organization should document the conditions in place that allow it to be considered free of organizational impairments to independence to report internally. Those conditions should be reviewed during the external quality assurance review to ensure that all the necessary safeguards have been met.*